

Purchasing Power

Background

Purchasing power in relation to retirement is the measure of how a benefit retains its value over time. The concern among PERS 1 and TRS 1 retirees is that because of inflation, their benefits may be losing purchasing power, particularly for those who have been retired for extended periods. The Select Committee on Pension Policy considered Purchasing Power to be among their four top priority issues to discuss during the 2004 interim.

Committee Activity

Presentations:

July 13, 2004 - Full Committee
August 17, 2004 - Full Committee

Subgroup Activity:

September 7, 2004 - Subgroup Meeting
October 19, 2004 - Subgroup Meeting
November 9, 2004 - Subgroup Meeting

Recommendation to Legislature

See “Plan 1 COLA/Gain-sharing” tab.

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Select Committee on Pension Policy

Purchasing Power

(December 15, 2004)

Issue

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Members Impacted

This issue primarily impacts Public Employees' Retirement System plan 1 (PERS 1) and Teachers' Retirement System plan 1 (TRS 1) members. As of the most recent valuation, there were 21,737 active and 54,006 retired PES 1 members, and 12,456 active and 33,148 retired TRS 1 members.

Current Situation

Currently, the purchasing power of PERS 1 and TRS 1 benefits is partially protected by the Uniform Increase they receive on July 1st of each year after one year of retirement and after age 66. The Uniform increase is a dollar amount multiplied by the members' total years of service; that product is added to a member's monthly benefit each year. As of July 1, 2004, the Uniform Increase Amount was \$1.21; a retiree who was at least age 66 with 30 years of service will be receiving a monthly increase of \$36.30.

The Uniform Increase Amount increases each year by at least 3%. When gain-sharing is available, distributions are made by enhancing the Uniform Increase amount and thus the Uniform COLA.

Also available to PERS 1 and TRS 1 members is the COLA payment option. Upon retirement, members may choose to take an actuarially adjusted benefit that increases each year with inflation to a maximum of 3% per year—similar to the Plan 2 COLA. This option became available in 1990, and gives members greater financial stability during retirement.

History

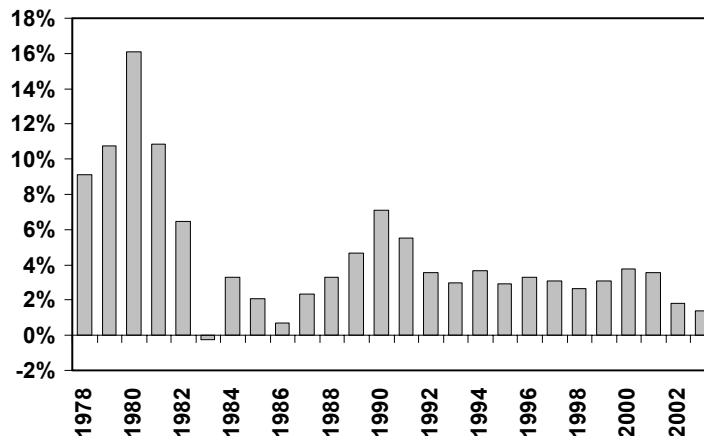
The PERS 1 and TRS 1 plans have experienced numerous legislative efforts to provide some level of purchasing power protection. The history of those efforts can be found in Appendix A of this report. These efforts began in 1961 with the establishment of a \$900/year minimum pension for those who retired at age 70 with at least 10 years of service. The most recent efforts lead to the \$1,000/ month Minimum Benefit legislation passed this year.

Less successful efforts to bolster TRS 1 and PERS 1 retiree's purchasing power have included bills seeking to increase the frequency of gain-sharing or lower the investment return threshold for determining when gain-sharing distributions occur. Gain-sharing, established in 1998, occurs on even-numbered years when the compounded rate of return on the TRS and PERS plan assets exceeds 10% over the most recent 4-year period. One-half of the amount in excess of 10% is distributed to TRS 1 and PERS 1 retirees via the Uniform COLA and to Plan 3 member's through their defined contribution accounts.

The legislative history of efforts to shore-up TRS 1 and PERS 1 retiree's purchasing power is a history of inflation; inflation being the reason retirement benefits lose purchasing power in the first place. Inflation is treated as a constant in the plan designs and within the actuarial valuations, which is appropriate considering the long-term character of retirement systems. For

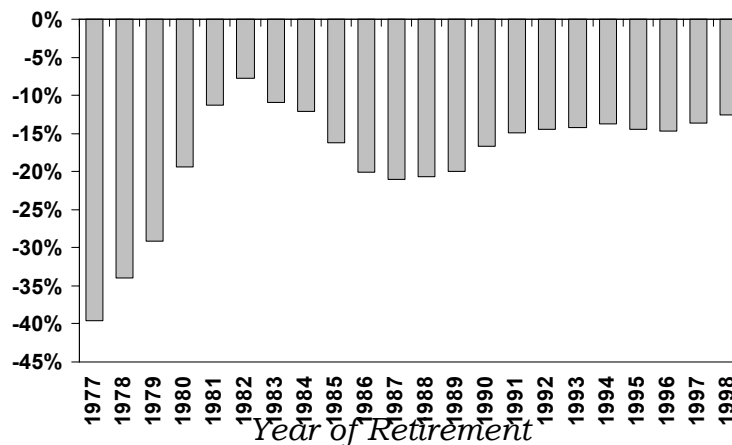
individuals, however, inflation is a variable that can change from year to year (see Figure 1). In the past 25 years, local changes in consumer prices have been as high as 16.1% and as low as -0.3%.

Figure 1
Annual Percent Changes
Seattle CPI-W: 1978-2003



Because of the variability of inflation, for those retirees whose benefit is not protected by a COLA, *when* they retire has a bearing on how their benefit retains its purchasing power. A worker who retired in 1977 would have seen their benefit lose almost 40% in value in the first five years of retirement (see Figure 2).

Figure 2
Purchasing Power Loss In the
First 5 Years of Retirement



Examples

Purchasing power is measured by comparing the change in member's benefits over time with the amount of inflation over the same period. In these examples, the Consumer Price Index for Wage Earners and Clerical Workers (CPI-W) for the Seattle-Tacoma-Bremerton region has been used for the inflation measure. Also used in this calculation are benefits members originally received upon retirement and benefits they currently receive (see Figure 3).

Figure 3 Purchasing Power Calculation

$(\text{Current Benefit} / \text{Original Benefit}) \times (\text{Original CPI-W} / \text{Current CPI-W})$

Current Benefit : \$1,164
Original Benefit : \$1,002
Original CPI-W : 369.0
Current CPI-W : 553.6
 $(\$1,164 / \$1,002) \times (369.0 / 553.6)$
 $116.2\% \times 66.7\% = 77.43\%$

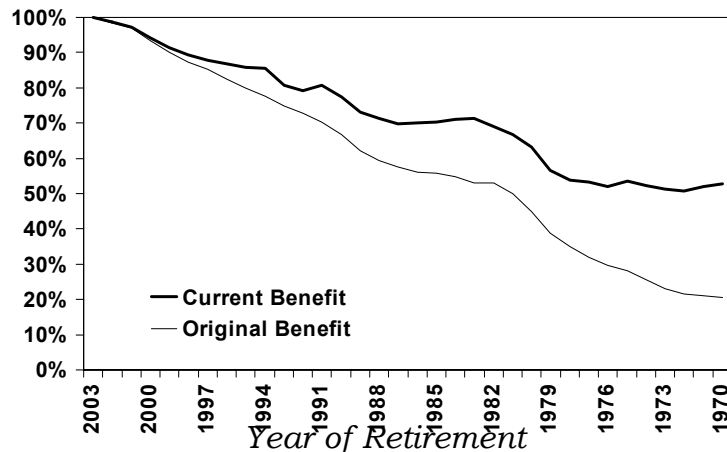
The above illustration uses the average benefit data from PERS 1 members who retired in 1990. By 2003, their average benefits had increased 16.2%. Inflation over the same period, as measured by the CPI-W, had increased by 50%. To determine the benefit's purchasing power, they must be deflated by a factor of .667. As a result, the current benefits have retained 77.4% of their original purchasing power.

This method was used to measure the purchasing power for all PERS and TRS members who retired from 1970 onward.

Plan 1 Examples

Figure 4 (following page) demonstrates the experience of PERS 1 members who have retired since 1970. The gap between the Original Benefit line and the Current Benefit line represents the COLAs that members have received.

Figure 4
Purchasing Power of PERS 1
Service Benefits in 2003

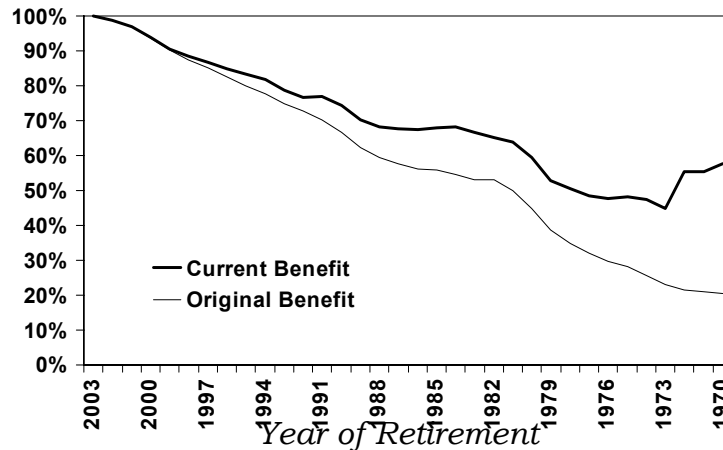


The varying slopes of the lines represent the changes in inflation with the steepest slopes being the periods of highest inflation. What this example illustrates is the relatively short time it takes for a PERS 1 benefit to lose a significant amount of value. Those who retired in 1999 have already lost 10% of their original benefit's purchasing power. At the most extreme point on this graph member benefits have experienced a loss of almost 50% of their original purchasing power.

Also evident in this graph is the potential loss of purchasing power if there had been no COLAs whatsoever. Had a member retired in 1970 and received no benefit improvements, their 2003 benefit would be worth but 20% of its original purchasing power.

The TRS 1 illustration (see Figure 5) is similar except for some obvious bump-up of benefits for those retired the longest. Early legislation that sought to improve retiree benefits tended to be system specific; TRS retirees benefitted from these COLAs. In addition, those retirees whose retirement allowance had lost the most are those who receive the greatest improvement from the current Uniform increases, this was particularly evident for those TRS 1 members who retired in 1970-1972 under the 1% plus annuity formula.

Figure 5
Purchasing Power of TRS 1
Service Benefits in 2003



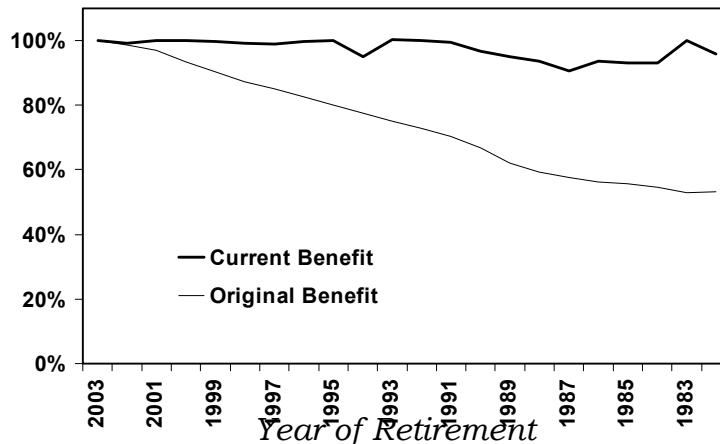
Because TRS members retire an average of 1.5 years younger than PERS members (58.5 years compared to 60 years), the decline in purchasing power is a bit more pronounced early in their retirement because they must wait longer to receive the Uniform COLA. Similar to PERS retirees though, those retired the longest have experienced a loss of about half their original purchasing power.

Plan 2/3 Examples

Purchasing power trends in the plans 2/3 offer a telling contrast to PERS 1 and TRS 1. Retired plan 2/3 members receive a CPI-based COLA beginning one year after retirement (the plan 3 COLA covers the defined benefit). In addition, plan 2/3 members receive the COLA even when they opt for early retirement.

A similar COLA is a payment option for PERS 1 and TRS 1 retirees. By taking the COLA payment option, members accept an actuarially reduced initial benefit in order to receive CPI-based COLAs (to a maximum of 3% per year.) This provides plan 1 members a more stable benefit stream.

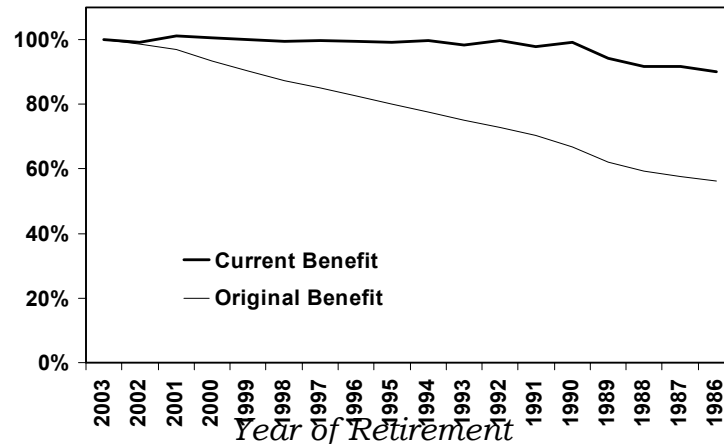
Figure 6
Purchasing Power of PERS 2/3
Service Benefits in 2003



PERS 2/3 purchasing power patterns are distinctive in their stability. Even after twenty-one years of retirement, member's benefits lost only 5% of their original purchasing power (see Figure 6). And that loss may not be permanent; COLA design in the plans 2/3 allows benefits to "catch-up" during low-inflation years. In comparison, after twenty-one years, PERS 1 member's benefits had lost 31% of their original purchasing power.

TRS 2/3 purchasing power patterns differ from those of PERS 2/3 only in that the first TRS 2 retirements were in 1986 while the first PERS 2 retirements were in 1982.

Figure 7
Purchasing Power of TRS 2/3
Service Benefits in 2003



TRS 2/3 benefits have retained their purchasing power similar to those of PERS 2/3. After seventeen years of retirement the average TRS 2/3 benefit retained 90% of its purchasing power (see Figure 7). This is a bit different than the PERS 2/3 benefit in that inflation in eight of the last seventeen years was above 3%. More recently it has been below 3%, meaning that those TRS 2/3 members who retired in 1986-1989 may experience some COLA catch-up over the next several years. Nonetheless, the benefit design allows members to retain a significant level of their original purchasing power over extended periods.

Policy Analysis

The means to protect retiree benefits from loss of purchasing power is by cost-of-living-adjustments (COLAs). The original design of TRS 1 and PERS 1 did not include an automatic COLA. This was not necessarily an oversight in the plan, which was established in 1947, but was more likely because few retirement plans had automatic COLAs at that time; even Social Security benefits were not inflation indexed until 1975. Because of the absence of an original automatic COLA, the lost purchasing power of TRS 1 and PERS 1 benefits has been addressed by frequent ad hoc efforts and sometimes complex legislation for those whose benefits had lost significant purchasing power.

The need for an automatic COLA was acknowledged in the design of the Plans 2 and 3, which include a CPI-based COLA that begins one year after retirement, including early retirement. The policy decision driving that design was that "...retiree benefits should have some form and degree of protection from inflation." In recognition of the cost of such a benefit, plan 2 design also incorporated an age-based retirement requirement (age 65 with at least 5 years of service) and did not include the service-based retirement criteria of plan 1 (30 years of service at any age).

Policy Constraints

The retirement policy that may constrain any benefit improvements in PERS 1 and TRS 1 seeks to "... fund benefit increases for plan members over the working lives of those members so that the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service." This policy is based on the concept of inter-generational equity. As the plan 1s have been closed since 1977, as there are now more retirees than active members, and as the employee contribution rate is fixed in statute, the source of contributions to fund any improvement becomes, more and more, taxpayers who never received services from these members.

Fiscal Constraints

Because of the significant losses of purchasing power, the cost of any remedy would be similarly significant. Were it decided that PERS 1 and TRS 1 retiree allowances should not fall below 60% of their original purchasing power, then the allowances of 4,800 PERS and 3,700 TRS service retiree's would need to be adjusted. In the first year alone, the cost would be almost \$13 million dollars.

Figure 8
First Year Cost to Fund Minimum
Levels of Purchasing Power
For PERS 1 and TRS 1 Service Retirees (\$millions)

	Level of Original Purchasing Power		
	60%	70%	80%
PERS 1	\$4.9	\$14.5	\$43.7
TRS 1	\$8.0	\$21.4	\$50.7
Total	\$12.9	\$35.9	\$94.4

Demographic Issues

Demographic trends play a tangential role in purchasing power analysis. As retirees continue to live longer, the more inflation can erode their retirement benefits. PERS 1 members tend to retire at 60 years of age and TRS 1 members at 58.5 years of age. So on average, PERS retirees will go about 6 years before receiving their first Uniform COLA and TRS retirees will go 7½ years. On top of that, according to the most recent life-expectancy tables, a PERS female retiring today at age 60 can expect to live another 24 years (see Figure 9). The average TRS female retiring today can expect to live another 27.1 years.

Figure 9
Life Expectancy at Average
Retirement Age

	Male	Female
PERS (age 60)	21.4	24.0
TRS (age 58½)	24.5	27.1

Comparisons with other Washington Systems/Plans

There are three post-retirement COLA designs in Washington's retirement systems: the fully indexed benefit for Law Enforcement Officers and Fire Fighter's (LEOFF) plan 1 retirees, the CPI-based 3% capped COLA for plan 2/3 retirees, and the Uniform Increase for TRS 1 and PERS 1 retirees.

The monthly retirement benefit for a member of the Law Enforcement Officer's and Fire Fighter's plan 1 is fully indexed to the CPI-W for the Seattle-Tacoma-Bremerton region. On April 1 of each year, beginning one year after retirement, the members' benefits are adjusted based on the annual percent increase in the CPI as measured over the previous calendar year.

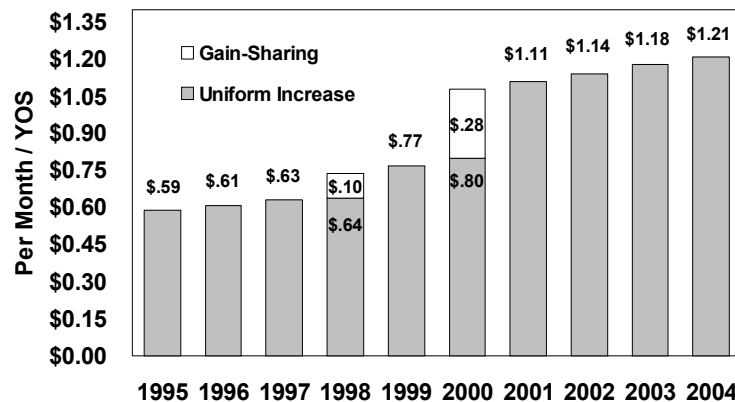
The monthly retirement benefit for a member of the plan 2s, and the defined benefit portion of the plan 3s, is indexed to the CPI-W for the Seattle-Tacoma-Bremerton region to a maximum of 3% per year. On July 1 of each year, beginning one year after retirement, the members' benefits are adjusted based on the annual percent increase in the CPI as measured over the retiree's entire period of retirement.

Monthly retirement benefits for PERS 1 and TRS 1 members are adjusted by what is known as the Uniform COLA. The Uniform COLA is the product of the Uniform Increase Amount multiplied by each retirees years of service (yos). The Uniform Increase Amount grows at 3% per year and is also enhanced by gain-sharing (see Figure 10).

Figure 10

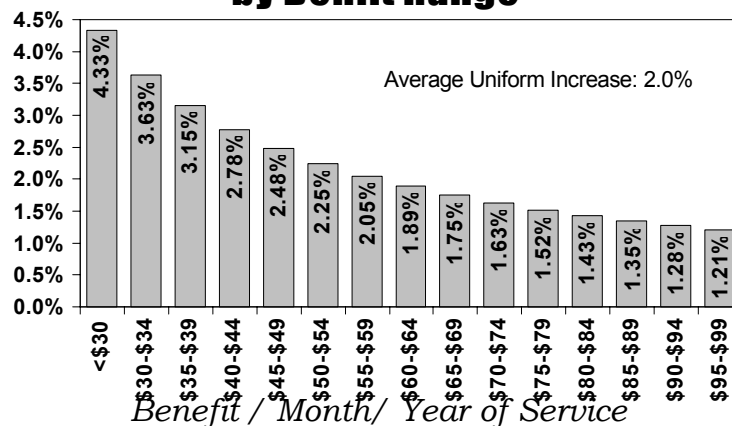
PERS 1 & TRS 1

Uniform Increase Amount



Unlike the aforementioned COLAs that apply the same percent increase to each member's benefit, the Uniform increase is based solely on years of service. As a result, a retiree with 30 years of service and a low benefit will receive the same dollar adjustment as a retiree with 30 years of service and a high benefit. This rewards low benefit retirees with greater purchasing power protection than high benefit retirees (see Figure 11).

Figure 11
Uniform COLA Percent Increase
by Benefit Range



The ability of the Plan 1 Uniform COLA to protect retiree's purchasing power after age 66 is illustrated in the following Figures. The "illustrations" assume the member retires at various ages with a \$1,500/month benefit. The benefit value is deflated by the actual changes in Seattle area consumer prices as measured by the CPI-W. The member begins receiving the annual Uniform increases in 1995 when reaching age 66 (birthday prior to July 1.)

Figure 12 illustrates the deflated benefit stream of a member retiring at age 55 in 1984. At age 55 the member will have to wait 11 years before receiving their first COLA. Based on the changes in consumer prices over that period, the benefit would have declined to about \$1,059 in current value by 1995 (see Figure 12). Upon receipt of the Uniform COLA the benefit would stabilize, and by 2004 it would have retained much of its 1995 value. If not for the COLA, the benefit would have been worth just over half its original value by 2004.

Figure 12
Plan 1 Purchasing Power
For a Member Retiring at Age 55

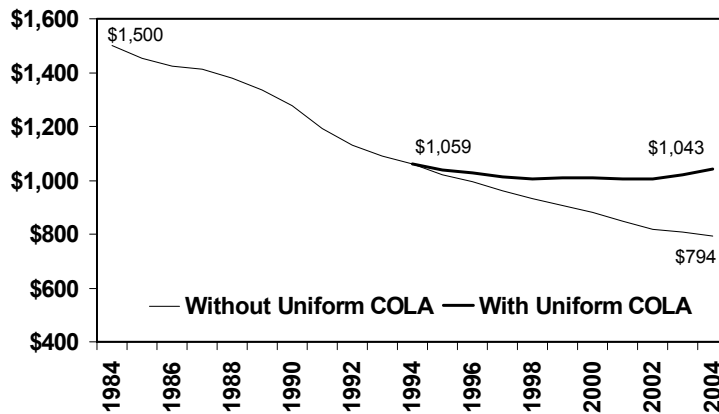
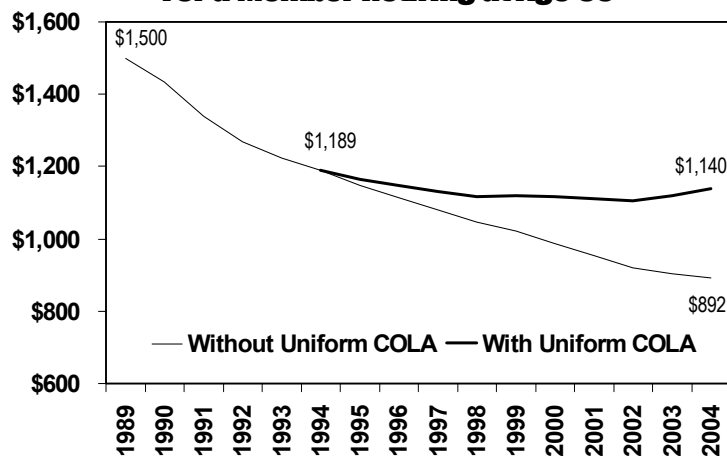


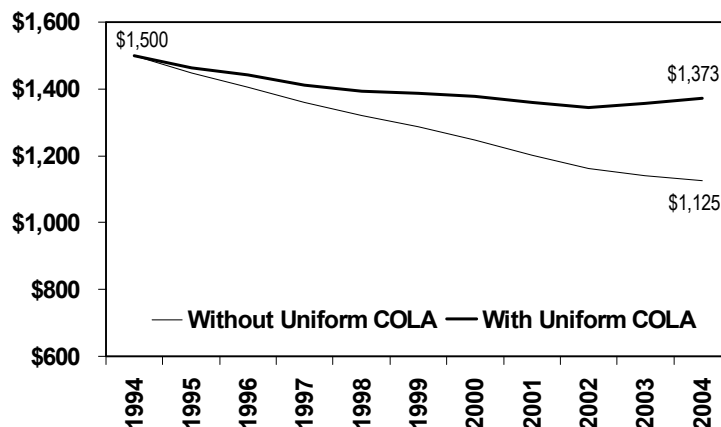
Figure 13
Plan 1 Purchasing Power
For a Member Retiring at Age 60



In Figure 13 the member's benefit loses about 20% of its original purchasing power before eligibility to receive the Uniform Increase. Even after receiving the Uniform Increase, the benefit still loses value until 2002 when it begins to recover, inching back to 76% of its original purchasing power by 2004. Were it not for the Uniform increase, the benefit would have continued to lose purchasing power, declining to less than 60% of its original value by 2004.

A member who retired at age 65 in 1994 would have an entirely different experience. By not having to wait an extended period before being eligible for the Uniform COLA, their benefit loses considerably less purchasing power (see Figure 14). By 2004, this member's benefit would be over \$250 per month above where it would have been without the COLA.

Figure 14
Plan 1 Purchasing Power
For a member Retiring at Age 65



Comparisons with Other State and City Plans

Among the eleven systems chosen to provide a standard comparison, all provide some form of COLA (see Figure 15). Five of those systems provide COLAs that are CPI based with varying caps, the highest being 6%, the lowest being 2%. The remaining systems provide percent increases that range from a low of 1.5% to a high of 3.5%. Most begin after 1 year of retirement; Florida and Idaho provide prorated COLAs for those retired less than one year.

Figure 15
COLA Provisions by Select Retirement Systems

System	COLA
Cal PERS	2% (80% purchasing power min.)
Cal STRS	2% simple (80% purchasing power min.)
Colorado PERA*	3.5%
Florida (FRS)	3%
Idaho (PERSI)	CPI based, 1% min, 6% max,

System	COLA
Iowa (IPERS)	Simple increase: 3% max
Minnesota (MSRS)	CPI based, 2.5% max + investment surplus
Missouri (MOSERS)*	80% of change in the CPI, 5% max
Ohio (OPERS)*	CPI based, 3% max
Oregon PERS*	CPI based, 2% max
Seattle (SCERS)	1.5% (60% purchasing power min.)

Several of the comparison systems provide protection against specific losses of purchasing power. Benefits in the California systems cannot fall below 80% of the original benefit's purchasing power. Benefits in the Seattle system cannot fall below 60% of their original purchasing power. This is similar to a 1992 COLA provision that protected PERS 1 and TRS 1 members from the loss of 40% of their age 65 benefit's purchasing power.

Human Resource Impact

The absence of a COLA for TRS 1 and PERS 1 members who retire before age 65 may have an impact on public sector human resource policies in Washington State. The post-retirement employment issue is driven by numerous factors, one of which may include a member's fear of losing the purchasing power of their benefit. Returning to work after retiring is a reasonable choice for those hoping to accrue additional assets to help cover future inflation and other fast-growing expenses.

The loss of a retirement benefit's purchasing power tends to be a gradual process. But even modest amounts of inflation can have significant long-term effects. Recognition of this phenomena resulted in the COLA provisions in the plan 2/3 designs, and also the most recent efforts to provide some systematic benefit protections in PERS 1 and TRS 1. The Uniform Increase provides some protection over inflation -- a phenomenon totally outside the member's control. Members may also choose the Optional COLA payment upon retirement, which gives them greater control and benefit stability.

As PERS 1 and TRS 1 are closed plans with more annuitants than active members, additional COLA improvements would be more difficult to provide under existing funding policy.

Funding: Ad Hoc vs. Permanent

There are differing funding mechanisms if a benefit increase is ad hoc or permanent. An ad hoc benefit is a one-time increase that must be funded in the year in which it is given [RCW 41.45.070(5)] – akin to pay-as-you-go. In general, benefit increases to inactive members would tend to be ad hoc – active members would not tend to be effectively eligible for whatever benefit had been granted. A permanent benefit increase tends to be prospective, though not exclusively, with all active members, and sometimes retirees, receiving the benefit; and employer contribution rates will increase to pay for the benefit. Because of the funding method in PERS 1 and TRS 1, permanent benefit increases are rolled into each plan's unfunded actuarially accrued liability (UAAL) – this is similar to an individual taking out a second mortgage – and funded through the amortization date (June 30, 2024).

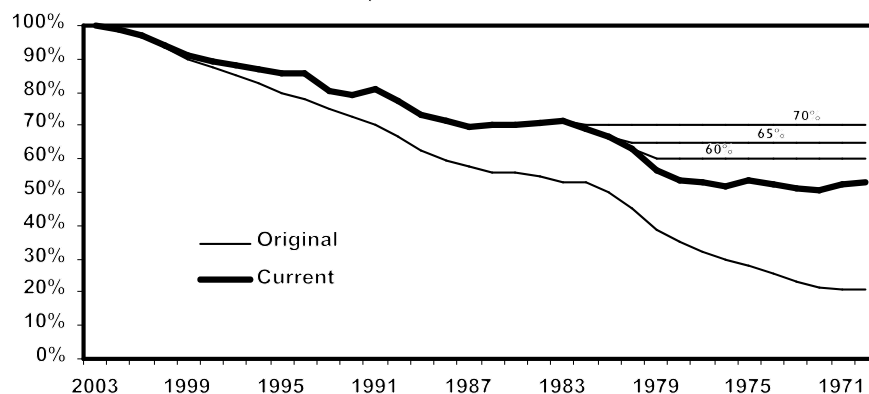
Options to Recover and Maintain Purchasing Power

These options fall into two broad groups -- those that will result in recovery of lost purchasing power, and those that will maintain purchasing power. Options 1-4 would allow those who have been retired for extended periods recover a portion of their lost purchasing power. Though all retirees will eventually receive the Uniform COLA, only those with long service and relatively small allowances are able to recover some of their lost purchasing power through receipt of the Uniform COLA. Options 5-9 are more conceptual in nature; they would allow current and future retirees to maintain their purchasing power. While many retirees are at least able to maintain their purchasing power from the point at which they became eligible for the Uniform COLA, the loss of purchasing power prior to receipt of the COLA is normally quite substantial for those who retire prior to age 60.

Option 1: Establish a permanent minimum purchasing power floor under which retirees could not fall. Several comparative systems – CalPERS, CalSTRS, Seattle City Employees Retirement System – use these kinds of provisions. That floor could be set at 60%, 65%, or 70% of the original benefit's purchasing power (see Figure 1). Because these purchasing power losses are based on the timing of a member's retirement, the effect would be to boost the allowance of those retired prior to a specific date. For instance, PERS members whose benefit is less than 60% of its original purchasing power retired prior to 1980; this is about 9,400

retirees. TRS members whose benefit is currently less than 60% of its original purchasing power retired prior to 1981; about 6,300 retirees.

Figure 1
Purchasing Power of PERS 1 Benefits with 60%,
65%, and 70% Floors



This would initially appear to be an ad hoc benefit -- a one-time bump-up with future allowances protected by the Uniform COLA. However, for retirees with less than 20 years of service, the Uniform COLA may not keep up with projected inflation. As a result, the funding would need to be permanent. This option would have a significant actuarial cost and a high administrative impact for the Department of Retirement Systems (the Department).

While the Uniform COLA provides some degree of protection from inflation, as per existing retirement system policy, this option would enhance that policy to set a minimum purchasing power floor. The 60% floor would also increase the current unfunded liability by \$1,720 million. Any retroactive benefit increase may be in conflict with the policy to fund benefits over members' working lives.

Estimated Fiscal Impact of Establishing a Benefit Purchasing Power Floor

	% of Original Purchasing Power					
	60%		65%		70%	
(\$ in millions)	PERS	TRS	PERS	TRS	PERS	TRS
Increase in Unfunded Actuarial Accrued Liability (UAAL)	\$980	\$740	\$1,390	\$1,060	\$1,880	\$1,460
Increase in Employer Contribution Rate	0.70%	1.31%	0.99%	1.88%	1.35%	2.58%
General Fund						
1 st Biennium	\$31.2	\$80.0	\$44.1	\$114.7	\$60.2	\$157.4
25 Year	\$555.0	\$1,388.0	\$786.0	\$1,992.3	\$1071.1	\$2,733.6
Non-General Fund						
1 st Biennium	\$35.1	\$0.0	\$49.7	\$0.0	\$67.9	\$0.0
25 Year	\$612.5	\$0.0	\$866.4	\$0.0	\$1181.6	\$0.0
Local Government						
1 st Biennium	\$58.9	\$16.3	\$83.2	\$23.5	\$113.6	\$32.2
25 Year	\$1,035.3	\$284.1	\$1,464.6	\$407.5	\$1,997.9	\$559.6

Option 2: Enhance the Uniform COLA by boosting the Annual Increase Amount to provide greater purchasing power protection for recent retirees and recovery of purchasing power for earlier retirees. The Annual Increase Amount is currently \$1.21; each July 1, it increases by 3% plus any gain-sharing distributions. One proposal was to increase it to \$1.50 or \$2.00. Because the Annual Increase Amount goes up each year and would eventually reach those levels, this proposal provides a permanent early increase for eligible retirees. This option would have an actuarial cost and a low administrative impact for the Department.

While the Uniform COLA provides some degree of protection from inflation, as per existing retirement system policy, this option would still be in accordance with that policy and simply provide an early increase in the Uniform COLA amount. It would also increase the current unfunded liability by \$200 million. This would be a retroactive benefit increase and may be in conflict with the policy to fund benefits over members' working lives.

Estimated Fiscal Impact of Increasing the Annual Increase Amount by 10¢			
(\$ in millions)	PERS	TRS	TOTAL
Increase in Unfunded Actuarial Accrued Liability (UAAL)	\$110	\$90	\$200
Increase in Employer Contribution Rate	0.08%	0.17%	
General Fund			
1 st Biennium	\$3.6	\$10.3	\$13.9
25 Year	\$63.2	\$180.0	\$243.2
Non-General Fund			
1 st Biennium	\$4.0	\$0.0	\$4.0
25 Year	\$69.7	\$0.0	\$69.7
Local Government			
1 st Biennium	\$6.6	\$2.0	\$8.6
25 Year	\$117.9	\$36.3	\$154.2

Option 3: Increase the yearly multiplier for the Annual Increase Amount.

Currently the Annual Increase Amount increases by at least 3% per year. Since the actuarial inflation assumption is 3.5% per year, the multiplier for the Annual Increase Amount could be raised to 3.5% per year or higher (see Figure 2). Changing the adjustment factor would provide greater purchasing power protection for long service, low benefit retirees. This option would have a modest actuarial cost and a low administrative impact on the Department.

Figure 2
Yearly Multiplier for the Annual Increase Amount and Monthly Benefit for a Retiree with 20 Years of Service

		2004	2005	2006	2007	2008	2009	2010	2011
3.0%	Amount	\$1.21	\$1.25	\$1.29	\$1.33	\$1.37	\$1.41	\$1.45	\$1.49
	Benefit	\$24.20	\$25.00	\$25.80	\$26.60	\$27.40	\$28.20	\$29.00	\$29.80
3.5%	Amount	\$1.21	\$1.25	\$1.30	\$1.34	\$1.39	\$1.44	\$1.49	\$1.54
	Benefit	\$24.20	\$25.00	\$26.00	\$26.80	\$27.80	\$28.80	\$29.80	\$30.80
4.0%	Amount	\$1.21	\$1.26	\$1.31	\$1.36	\$1.42	\$1.47	\$1.53	\$1.59
	Benefit	\$24.20	\$25.20	\$26.20	\$27.20	\$28.40	\$29.40	\$30.60	\$31.80

While the Uniform COLA provides some degree of protection from inflation, as per existing retirement system policy, this option would still be in accordance with that policy and simply align the adjustment to the Annual Increase Amount with the current actuarial inflation assumption. The 3.5% multiplier would also increase the current unfunded liability by \$150 million. As this would be a retroactive benefit increase it may be in conflict with the policy to fund benefits over members' working lives.

Estimated Fiscal Impact of Increasing the Multiplier for the Annual Increase Amount				
	3.5%		4.0%	
(\$ in millions)	PERS	TRS	PERS	TRS
Increase in Unfunded Actuarial Accrued Liability (UAAL)	\$80	\$70	\$170	\$150
Increase in Employer Contribution Rate	0.06%	0.13%	0.12%	0.26%
General Fund				
1 st Biennium	\$2.6	\$8.0	\$5.3	\$15.9
25 Year	\$47.2	\$137.8	\$94.6	\$275.4
Non-General Fund				
1 st Biennium	\$3.0	\$0.0	\$5.9	\$0.0
25 Year	\$52.4	\$0.0	\$105.0	\$0.0
Local Government				
1 st Biennium	\$5.0	\$1.6	\$10.1	\$3.4
25 Year	\$88.0	\$28.0	\$177.2	\$56.2

Option 4: Increase the \$1,000 alternative minimum benefit by 3% per year. This would change an ad hoc benefit into a permanent benefit. The current minimum benefit is \$32.97 per month per year of service, and it increases each year by the Annual Increase Amount. At the latest, the minimum benefit will reach \$41.07 in 2010, thus surpassing the \$1,000 alternative minimum for a member with 25 years of service. By increasing the \$1,000 alternative minimum benefit by 3% per year, eligible retirees will be more able to retain that level of purchasing power. This option would have a modest actuarial cost and a low administrative impact on the Department.

While the Alternative Minimum Benefit provides some degree of protection from inflation, as per existing retirement system policy, this option would still be in accordance with that policy and simply change it from an ad hoc benefit to a permanent benefit. It would also increase the current unfunded liability by \$11 million. Any retroactive benefit increase may be in conflict with the policy to fund benefits over members' working lives.

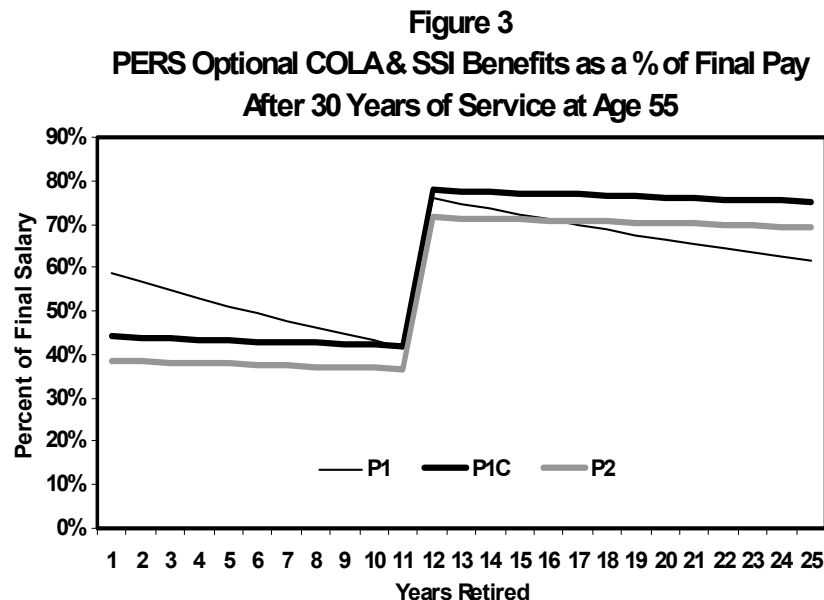
Estimated Fiscal Impact of Making the \$1,000 Minimum a Permanent Benefit that Increases by 3% per Year			
(\$ in millions)	PERS	TRS	TOTAL
Increase in Unfunded Actuarial Accrued Liability (UAAL)	\$7	\$4	\$11
Increase in Employer Contribution Rate	0.01%	0.01%	
General Fund			
1 st Biennium	\$0.4	\$0.5	\$0.9
25 Year	\$7.7	\$10.5	\$18.2
Non-General Fund			
1 st Biennium	\$0.5	\$0.0	\$0.5
25 Year	\$8.7	\$0.0	\$8.7
Local Government			
1 st Biennium	\$0.8	\$0.1	\$0.9
25 Year	\$14.5	\$2.1	\$16.6

Summary of Proposals to Recover Purchasing Power: Options 1 through 4		
(\$ in millions)	1st Biennium Cost	Administrative Impact
Title		
1. 60% Benefit Floor	\$221.5	High
1. 65% Benefit Floor	\$315.2	High
1. 70% Benefit Floor	\$431.3	High
2. Annual Increase Amount to 10¢	\$26.5	Low
3. Annual Increase Multiplier to 3.5%	\$20.2	Low
3. Annual Increase Multiplier by 4.0%	\$40.6	Low
4. Increase \$1,000 minimum 3% per year	\$2.3	Low

Maintaining Purchasing Power

The following proposals to maintain purchasing power are more conceptual than the first four. It is apparent that the recovery of lost purchasing power is costly. It may, therefore, be appropriate to engage in preventative measures so that future retirees are not subject to extended periods where they receive no inflation adjustment to their retirement benefit.

Option 5: Make the current Plan 1 COLA Payment Option the default during retirement calculations and the option would then be to refuse the COLA. At the same time, provide PERS 1 and TRS 1 members a higher level of education on the ramifications of opting out of the COLA; use of illustrations like Figure 3 to explain the advantages of the COLA option may result in greater utilization. This option would have no actuarial impact, but would have a medium administrative impact for the Department.

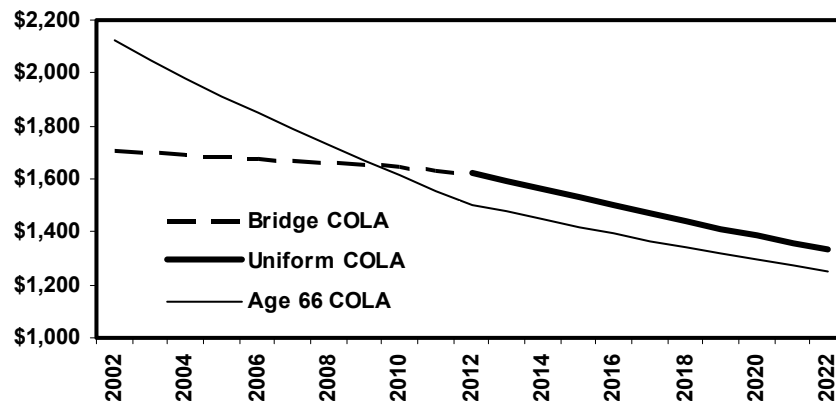


It is unlikely that this provision would be in conflict with existing retirement policies as it neither changes nor diminishes members' benefits.

Option 6: Offer a "Bridge COLA" for those PERS 1 and TRS 1 members retiring before age 65 that sunsets when members become eligible for the Uniform COLA. A member could choose an actuarially equivalent 1.5%, 2.0%, or 3% optional COLA payment

for however many years until the member becomes Uniform COLA eligible (see Figure 4). This option would have no actuarial impact, but would have a high administrative impact for the Department.

Figure 4
PERS 1 Benefit at Age 55
With Bridge COLA and Uniform COLA



While the Uniform COLA provides some degree of protection from inflation, as per existing retirement system policy, this option would still be in accordance with that policy and allow further purchasing power protection for those retiring several years before being eligible for the Uniform COLA.

Option 7: Modify the Plan 1 COLA Payment Option. The benefit of PERS 1 and TRS 1 members who chose the 3% COLA payment option upon retirement is actuarially reduced. Allow members to choose a 2% or 1.5% COLA payment option. The actuarial factors vary by age – younger retirees experience a greater reduction; the initial benefit of an age 55 retiree is reduced by about 25% should they choose the 3% COLA option. By offering a 1.5% COLA option, for example, the reduction in the initial benefit would be about half the reduction of the 3% COLA option, (see Figures 5 and 6). This option would have no actuarial impact, but would have a high administrative impact for the Department.

Figure 5
PERS 1 Actuarial Factors for
Various COLA Payment Options at Select
Retirement Ages

	COLA Payment Options		
	3.0%	2.0%	1.5%
Age 55	0.7510	0.8310	0.8722
Age 60	0.7731	0.8462	0.8837
Age 65	0.7972	0.8627	0.8963

Figure 6
Adjusted PERS Benefits at Select Ages
by COLA Payment Options: Average Benefit = \$2122

	COLA Payment Options		
	3.0%	2.0%	1.5%
Age 55	\$1,594	\$1,763	\$1,851
Age 60	\$1,641	\$1,796	\$1,875
Age 65	\$1,692	\$1,831	\$1,902

Option 8: Modify the Plan 1 COLA Payment Option. The benefit of PERS 1 and TRS 1 members who chose the COLA payment option upon retirement is actuarially reduced. By trading off the cost of the Uniform COLA, which includes gain-sharing, the actuarial impact for the 3% COLA payment option can be reduced. Because the Uniform COLA is based on service rather than average final compensation (AFC), it is of more value to members with long service and low benefits. As a result, the changes in actuarial factors would be based on both the member's service and AFC. This option would have no actuarial impact, but would have a medium administrative impact for the Department.

Option 9: Subsidize the Plan 1 COLA Payment Option. The benefit of PERS 1 and TRS 1 members who chose the COLA payment option upon retirement is actuarially reduced. As a result, those choosing this option pay for their own COLA. By providing an employer subsidy cost-sharing can be introduced, and the actuarial impact for the 3% COLA payment option can be reduced. This option would have an actuarial impact and a medium administrative impact for the Department.

Multiple Options

In order to respond to both the Purchasing Power issue and Adequacy of Benefits issue, and to simultaneously recover and maintain purchasing power, several of these options could be melded into one. This could be done, for example, by establishing the purchasing power floor below which retirees would not fall, and redesigning the PERS 1 and TRS 1 COLA provisions. In this manner, existing retiree purchasing power issues would be addressed and future retiree COLA issues would be eased. While the Uniform COLA and Annual Increase Amount are considered non-contractual, any revision to a material benefit must be undertaken with caution. In addition, the IRS recently released its latest Minimum Distribution regulations which have an impact on public sector COLAs, and any such modifications would likely need Tax Council review.

APPENDIX A**History of Post-Retirement Adjustments in TRS 1 and PERS 1**

Date	TRS 1	PERS 1
3/21/61 (SERS)		Minimum pension \$900/year if retired at age 70 with 10 or more years of service \$60/month if 15-19 years of service \$70/month if 20-24 years of service \$80/month if 25-29 years of service \$90/month if 30 or more years of service
3/21/67		Minimum benefit increases to: \$60/month if 12-15 years of service \$90/month if 16-19 years of service \$120/month if 20 or more years of service
7/1/67	Pension portion of benefit increased to \$5.50/month/year of service if age 65 and not qualified for Social Security	
3/25/69		Minimum benefit increases to: \$75/month if 12-15 years of service \$100/month if 16-19 years of service \$130/month if 20 or more years of service
7/1/70	Minimum benefit revised to \$5.50/month/year of service. Applicable to members retiring before 4/1/69. Applied to the pension portion of the benefit.	The following received for each \$1 of pension by year of retirement: '49 - \$1.5239 '56 - \$1.3687 '63 - \$1.2116 '50 - \$1.5386 '57 - \$1.3485 '64 - \$1.1960 '51 - \$1.5239 '58 - \$1.3031 '65 - \$1.1813 '52 - \$1.4110 '59 - \$1.2601 '64 - \$1.1620 '53 - \$1.3805 '60 - \$1.2501 '65 - \$1.1291 '54 - \$1.3702 '61 - \$1.2116 '66 - \$1.0980 '55 - \$1.3643 '62 - \$1.2255 '67 - \$1.0536
7/1/77		5.95% COLA applied to pension portion of the benefit if retired before 12/31/70.
7/1/72	5.9% COLA for all members retired before 7/1/71, plus an additional 5.4% for those retired between 7/1/69 and 6/30/70.	
4/25/73		Minimum benefit of \$6.50/month/year of service. 3% permanent increase based on assets in excess of current liabilities.
7/1/73	\$3/month/year of service for retirees not eligible for Social Security.	Increase of 1.0609% if the member retired before 1972 and their service retirement allowance was adjusted in section (1) for adjustment made of 4/25/73.

History of Post-Retirement Adjustments in TRS 1 and PERS 1 (cont)

Date	TRS 1	PERS 1
7/1/74	11.9% pension increase for those retired on 6/31/70. 2.9% pension increase for those retired 7/1/70 - 6/30/73. 3% COLA on total allowance for those retired on 12/31/73.	3% COLA for those retired prior to 12/31/73
7/1/75		3% COLA for those retired prior to 12/31/74
7/1/76	Minimum pension benefit of \$7.50/month/year of service if retired prior to 4/25/73.	3% COLA for those retired prior to 12/31/75
7/1/77	Minimum pension benefit of \$8.00/month/year of service if retired prior to 4/25/73.	3% COLA for those retired prior to 12/31/76
7/1/78		3% COLA for those retired prior to 12/31/77
7/1/79	Minimum pension benefit of \$10/month/year of service for retirees of 7/1/79. Disability and survivor benefits as of 12/31/78, and service benefits as of 7/1/74 permanently increased by \$0.8171 multiplied by the member's years of service.	Minimum pension benefit of \$10/month/year of service for retirees of 7/1/79. 3% COLA for those retired prior to 12/31/78.
7/1/80		3% COLA for those retired prior to 12/31/79.
7/1/81		Excess earnings adjustment no longer in effect as employer contribution rate increased above rate of 4/24/73.
7/1/83	\$0.74/month/year of service COLA to disability and survivor benefits being received on 12/31/82 and service retirement benefits being received on 7/1/78.	
7/1/86	Minimum benefit increased to \$13.00/month/year of service	
7/1/87	Permanent automatic 3% annual increase to the minimum benefit becomes effective. Minimum pension benefit increased to \$13.50/month/year of service.	
7/1/88	Minimum pension benefit increased to \$13.82/month/year of service.	
7/1/89	Minimum pension benefit increased by \$1 to \$14.91/month/year of service and then increased 3% to \$15.36/month/year of service. Permanent automatic COLA enacted for retirees whose age 65 purchasing power had been reduced by more than 40%.	
7/1/90	Minimum pension benefit increased 3% to \$15.72/month/year of service. 3% COLA for eligible retirees.	
7/1/91	Minimum pension benefit increased 3% to \$16.19/month/year of service. 3% COLA for eligible retirees.	
2/1/92	The current benefits of those eligible for the COLA adjusted to be equal to 60% of their age 65 retirement allowance.	
7/1/92	Minimum pension benefit increased 3% to \$16.68/month/year of service. 3% COLA for eligible retirees.	

History of Post-Retirement Adjustments in TRS 1 and PERS 1 (cont)

Date	TRS 1	PERS 1
7/1/93	<p>Minimum pension benefit increased 3% to \$17.18/month/year of service. 3% COLA for eligible retirees. Continuation of special adjustment effective 2/92. Temporary ad hoc COLA effective through 6/30/94, \$3/month/year of service for those retired 5 years, who were 70 years of age, and did not receive a COLA in 1992.</p>	
7/1/94	<p>Minimum pension benefit increased 3% to \$17.70/month/year of service. 3% COLA for eligible retirees. Special adjustment effective 2/92 made permanent. Temporary ad hoc COLA extended to 6/30/95. Provides \$3/month/year of service to eligible retirees.</p>	
7/1/95	<p>Uniform Increase established. Initial increase of \$0.59/month/year of service to be increased by 3% per year. Retirees are eligible for the Uniform Increase if they have been retired at least one year and are age 66 by July 1st in the calendar year in which the annual increase is given, or if their retirement allowance is lower than the minimum benefit amount.. Minimum benefit increased to \$24.22/month/year of service, and to automatically increase each year by the Annual Increase amount. Temporary ad hoc COLA that had been extended to 6/30/95 made permanent.</p>	
7/1/98	<p>Gain-sharing established, providing even-year enhancements to the Annual Increase amount based on half the compound average investment returns in TRS 1 and PERS 1 plan assets over the previous four fiscal years that exceed 10%.</p>	
7/1/04	<p>\$1,000 minimum benefit (before optional benefit payments) established for retirees with 25 years of service and at least 20 years of retirement. Does not include an automatic increase. Effectively sunsets after the regular minimum increases to \$40/month/year of service.</p>	